

property the stock of a corporation (issuing corporation) acquired for property by another corporation (acquiring corporation) that is controlled by the deemed acquiring corporation, if a principal purpose for creating, organizing, or funding the acquiring corporation by any means (including, through capital contributions or debt) is to avoid the application of section 304 to the deemed acquiring corporation. See paragraph (c) *Example 1* of this section for an illustration of this paragraph.

(2) *Deemed issuing corporation.* The acquiring corporation shall be treated as acquiring for property the stock of a corporation (deemed issuing corporation) controlled by the issuing corporation if, in connection with the acquisition for property of stock of the issuing corporation by the acquiring corporation, the issuing corporation acquired stock of the deemed issuing corporation with a principal purpose of avoiding the application of section 304 to the deemed issuing corporation. See paragraph (c) *Example 2* of this section for an illustration of this paragraph.

(c) *Examples.* The rules of this section are illustrated by the following examples:

Example 1. (i) *Facts.* P, a domestic corporation, wholly owns CFC1, a controlled foreign corporation with substantial accumulated earnings and profits. CFC1 is organized in Country X, which imposes a high rate of tax on the income of CFC1. P also wholly owns CFC2, a controlled foreign corporation with accumulated earnings and profits of \$200x. CFC2 is organized in Country Y, which imposes a low rate of tax on the income of CFC2. P wishes to own all of its foreign corporations in a direct chain and to repatriate the cash of CFC2. In order to avoid having to obtain Country X approval for the acquisition of CFC1 (a Country X corporation) by CFC2 (a Country Y corporation) and to avoid the dividend distribution from CFC2 to P that would result if CFC2 were the acquiring corporation, P causes CFC2 to form CFC3 in Country X and to contribute \$100x to CFC3. CFC3 then acquires all of the stock of CFC1 from P for \$100x.

(ii) *Result.* Because a principal purpose for creating, organizing or funding CFC3 (acquiring corporation) is to avoid the application of section 304 to CFC2 (deemed acquiring corporation), under paragraph (b)(1) of this section, for purposes of determining the amount of the \$100x distribution constituting a dividend (and source thereof) under section

304(b)(2), CFC2 shall be treated as acquiring the stock of CFC1 (issuing corporation) from P for \$100x. As a result, P receives a \$100x distribution, out of the earnings and profits of CFC2, to which section 301(c)(1) applies.

Example 2. (i) *Facts.* P, a domestic corporation, wholly owns CFC1, a controlled foreign corporation with substantial accumulated earnings and profits. The CFC1 stock has a basis of \$100x. CFC1 is organized in Country X. P also wholly owns CFC2, a controlled foreign corporation with zero accumulated earnings and profits. CFC2 is organized in Country Y. P wishes to own all of its foreign corporations in a direct chain and to repatriate the cash of CFC2. In order to avoid having to obtain Country X approval for the acquisition of CFC1 (a Country X corporation) by CFC2 (a Country Y corporation) and to avoid a dividend distribution from CFC1 to P, P forms a new corporation (CFC3) in Country X and transfers the stock of CFC1 to CFC3 in exchange for CFC3 stock. P then transfers the stock of CFC3 to CFC2 in exchange for \$100x.

(ii) *Result.* Because a principal purpose for the transfer of the stock of CFC1 (deemed issuing corporation) by P to CFC3 (issuing corporation) is to avoid the application of section 304 to CFC1, under paragraph (b)(2) of this section, for purposes of determining the amount of the \$100x distribution constituting a dividend (and source thereof) under section 304(b)(2), CFC2 (acquiring corporation) shall be treated as acquiring the stock of CFC1 from P for \$100x. As a result, P receives a \$100x distribution, out of the earnings and profits of CFC1, to which section 301(c)(1) applies.

(d) *Effective/applicability date.* This section applies to acquisitions of stock occurring on or after December 29, 2009. See § 1.304-4T, as contained in 26 CFR part 1 revised as of April 1, 2008, for acquisitions of stock occurring on or after June 14, 1988, and before December 29, 2009.

(e) *Expiration date.* This section expires on or before December 28, 2012.

[T.D. 9477, 74 FR 69023, Dec. 30, 2009; 75 FR 8796, Feb. 26, 2010]

§ 1.304-5 Control.

(a) *Control requirement in general.* Section 304(c)(1) provides that, for purposes of section 304, control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock. Section 304(c)(3) makes section 318(a) (relating to constructive ownership of

stock), as modified by section 304(c)(3)(B), applicable to section 304 for purposes of determining control under section 304(c)(1).

(b) *Effect of section 304(c)(2)(B)*—(1) *In general.* In determining whether the control test with respect to both the issuing and acquiring corporations is satisfied, section 304(a)(1) considers only the person or persons that—

(i) Control the issuing corporation before the transaction;

(ii) Transfer issuing corporation stock to the acquiring corporation for property; and

(iii) Control the acquiring corporation thereafter.

(2) *Application.* Section 317 defines property to include money, securities, and any other property except stock (or stock rights) in the distributing corporation. However, section 304(c)(2)(B) provides a special rule to extend the relevant group of persons to be tested for control of both the issuing and acquiring corporations to include the person or persons that do not acquire property, but rather solely stock from the acquiring corporation in the transaction. Section 304(c)(2)(B) provides that if two or more persons in control of the issuing corporation transfer stock of such corporation to the acquiring corporation, and if the transferors are in control of the acquiring corporation after the transfer, the person or persons in control of each corporation include each of those transferors. Because the purpose of section 304(c)(2)(B) is to include in the relevant control group the person or persons that retain or acquire acquiring corporation stock in the transaction, only the person or persons transferring stock of the issuing corporation that retain or acquire any proprietary interest in the acquiring corporation are taken into account for purposes of applying section 304(c)(2)(B).

(3) *Example.* This section may be illustrated by the following example.

Example. (a) A, the owner of 20% of T's only class of stock, transfers that stock to P solely in exchange for all of the P stock. Pursuant to the same transaction, P, solely in exchange for cash, acquires the remaining 80% of the T stock from T's other shareholder, B, who is unrelated to A and P.

(b) Although A and B together were in control of T (the issuing corporation) before the

transaction and A and B each transferred T stock to P (the acquiring corporation), sections 304(a)(1) and (c)(2)(B) do not apply to B because B did not retain or acquire any proprietary interest in P in the transaction. Section 304(a)(1) also does not apply to A because A (or any control group of which A was a member) did not control T before the transaction and P after the transaction.

(c) *Effective date.* This section is effective on January 20, 1994.

[T.D. 8515, 59 FR 2960, Jan. 20, 1994]

§ 1.305-1 Stock dividends.

(a) *In general.* Under section 305, a distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock is not included in gross income except as provided in section 305(b) and the regulations promulgated under the authority of section 305(c). A distribution made by a corporation to its shareholders in its stock or rights to acquire its stock which would not otherwise be included in gross income by reason of section 305 shall not be so included merely because such distribution was made out of Treasury stock or consisted of rights to acquire Treasury stock. See section 307 for rules as to basis of stock and stock rights acquired in a distribution.

(b) *Amount of distribution.* (1) In general, where a distribution of stock or rights to acquire stock of a corporation is treated as a distribution of property to which section 301 applies by reason of section 305(b), the amount of the distribution, in accordance with section 301(b) and § 1.301-1, is the fair market value of such stock or rights on the date of distribution. See *Example (1)* of § 1.305-2(b).

(2) Where a corporation which regularly distributes its earnings and profits, such as a regulated investment company, declares a dividend pursuant to which the shareholders may elect to receive either money or stock of the distributing corporation of equivalent value, the amount of the distribution of the stock received by any shareholder electing to receive stock will be considered to equal the amount of the money which could have been received instead. See *Example (2)* of § 1.305-2(b).

(3) For rules for determining the amount of the distribution where certain transactions, such as changes in